

If You're Self-Employed

The majority of people who pay into Social Security work for someone else. Their employer deducts Social Security taxes from their paycheck, matches that contribution and sends wage reports and taxes to the Internal Revenue Service (IRS) and Social Security. But self-employed people must report their earnings and pay the taxes directly to the IRS. This factsheet explains that process.

You are self-employed if you operate a trade, business or profession, either by yourself or as a partner. You report your earnings for Social Security when you file your federal income tax return. If your net earnings are \$400 or more in a year, you must report your earnings on schedule SE for Social Security purposes, in addition to the other tax forms you must file.

Paying Social Security And Medicare Taxes

The Social Security tax rate for 2000 is 15.3 percent (the same as 1999) on self-employment income up to \$76,200. If your net earnings exceed \$76,200, you continue to pay only the Medicare portion of the Social Security tax, which is 2.9 percent, on the rest of your earnings. There are two income tax deductions that reduce your tax liability. The deductions are intended to make sure self-employed people are treated in much the same way as employers and employees for Social Security and income tax purposes.

First, your net earnings from self-employment are reduced by an amount equal to half of your total Social Security tax. This is similar to the way employees are treated under the tax laws in that the employer's share of the Social Security tax is not considered income to the employee.

Second, you can deduct half of your Social Security tax on the face of the IRS Form 1040 (line 25). This means the deduction is taken from your gross income in determining adjusted gross income. It cannot be an itemized deduction and must not be listed on your Schedule C.

If you have wages as well as self-employment earnings, the tax on your wages is paid first. But

this rule is important only if your total earnings are more than \$76,200. For example, if you have \$20,000 in wages and \$30,000 in self-employment income in 1999, you pay the appropriate Social Security taxes on both your wages and business earnings. However, if your 2000 wages are \$75,000 and you have \$10,000 in net earnings from a business, you do **not** pay dual Social Security taxes on earnings above \$76,200. Your employer will withhold 7.65 percent in Social Security taxes up to \$76,200 and 1.45 percent (the Medicare portion of an employee's tax rate) on earnings between \$72,600 and \$75,000. And you must pay the 2.9 percent Medicare self-employment tax (not the full Social Security tax) on your \$10,000 in self-employment earnings.

Earnings Credits

You need earnings credits to qualify for Social Security benefits. The number of credits you need depends on your date of birth, but no one needs more than 40. You can earn up to four credits per year.

If your net earnings are \$3,120 or more, you earn four credits—one for each \$780 of earnings. (If your net earnings are less than \$780, you still may earn one or more credits by using the optional method described later in this factsheet.)

All of your earnings covered by Social Security are used in figuring the amount of your Social Security benefit. So, it's important that you report all of your earnings up to the maximum as required by law.

Figuring Your Net Earnings

Net earnings for Social Security are your gross earnings from your trade or business, minus all of your allowable business deductions and depreciation.

Some income doesn't count for Social Security. Don't include the following in figuring your net earnings:

- dividends from shares of stock and interest on bonds, unless you receive them as a dealer in stocks and securities;
- interest from loans, unless your business is lending money;
- rentals from real estate, unless you are a real estate dealer or regularly provide services mostly for the convenience of the occupant; or
- income received from a limited partnership.

Optional Method

If your actual net earnings are less than \$400, your earnings can still count for Social Security under an optional method of reporting. The optional method can be used if your gross earnings are \$600 or more or when your profit is less than \$1,600.

You can use the optional method **no more than five times**. Your actual net must have been \$400 or more in at least two of the last three years, and your net earnings must be less than two-thirds of your gross income.

Here's how it works:

- if your gross income from self-employment is between \$600 and \$2,400, you may report two-thirds of your gross **or** your actual net earnings if \$400 or more; or
- if your gross income is \$2,400 or more and the actual net earnings are \$1,600 or less, you report **either** \$1,600 **or** your actual net.

Special Note For Farmers: If you're a farmer, you can use the optional reporting method every year. It's not necessary to have had actual net earnings of at least \$400 in a preceding year. We suggest you call Social Security and ask for the booklet, **A Guide for Farmers, Growers, and Crew Leaders** (Publication No. 05-10025), for information on how to report your earnings.

How To Report Earnings

You must complete the following federal tax forms by April 15 following any year in which you have net earnings of \$400 or more:

- Form 1040 (**U.S. Individual Income Tax Return**);
- Schedule C (**Profit or Loss from Business**) or Schedule F (**Profit or Loss from Farming**) as appropriate; and
- Schedule SE (**Self-Employment Tax**).

These forms can be obtained from the IRS and most banks and post offices.

Send the tax return and schedules along with your self-employment tax to the IRS.

Even if you don't owe any income tax, you must complete Form 1040 and Schedule SE to pay self-employment Social Security tax. This is true even if you already get Social Security benefits.

Church Workers

If you are considered self-employed because of your work for a church or church-controlled organization, you must report earnings of \$100 or more. For more information, ask Social Security for the factsheet, **If You Work For A Nonprofit Organization** (Publication No. 05-10027).

Family Business Arrangements

Family members may operate a business together. A husband and a wife may be partners or running a joint venture. If you operate a business together as partners, you should each report your share of the business profits as net earnings on separate schedules, even if you file a joint income tax return. The amount each of you should report depends upon your agreement.

Social Security's Toll-Free Number

1-800-772-1213

Call 24 hours a day,
including weekends and holidays.

To speak to a representative,
call between 7 a.m. and 7 p.m.

any business day
TTY: 1-800-325-0778
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